

Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, DC 20554

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**APR 28 1997**

In the Matter of )

Requests of U S WEST Communications, )  
Inc. for Interconnection Cost Adjustment )  
Mechanisms )

CC Docket No. 97-90  
CCB/CPD 97-12

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF SECRETARY

**REPLY COMMENTS OF U S WEST, INC.**

U S WEST, Inc. hereby submits its reply to comments on the Petition for Declaratory Ruling and Contingent Petition for Preemption filed by Electric Lightwave, Inc., McLEODUSA Telecommunications Services, Inc. and NEXTLINK Communications, L.L.C. ("Petitioners") in the above-captioned proceeding.<sup>1</sup> Petitioners seek a declaratory ruling that U S WEST Communications, Inc.'s ("U S WEST") state filings treating the costs of providing interconnection to interconnecting carriers be declared both unlawful and beyond the jurisdiction of state commissions administering interconnection proceedings. U S WEST, Inc.'s basic position on this issue was set forth in its March 3, 1997 Opposition.<sup>2</sup>

U S WEST's Interconnection Cost Adjustment Mechanism ("ICAM") filings are an approach designed to identify accurately unbundling and interconnection start-up costs. It is a vehicle used in presenting cost recovery arguments to state

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<sup>1</sup> Petition for Declaratory Ruling and Contingent Petition for Preemption, filed Feb. 20, 1997 ("Petition").

<sup>2</sup> Opposition of U S WEST, Inc. to Petition for Declaratory Ruling and Contingent Petition for Preemption, filed Mar. 3, 1997.

decision-makers — in other words, it is a tool which presents accurate cost information to those entrusted with making initial pricing decisions under the 1996 Telecommunications Act. The ICAM itself is not a decision, not a judgment, nor even a uniform approach in all state pricing proceedings because the actual methodology of recovering costs identified by the ICAM can vary from state to state depending on how a particular state chooses to treat interconnection start-up costs. Thus, a declaratory ruling that states could not consider the U S WEST ICAM would obviously be premature no matter how one viewed either the ICAM itself or the scope of the Federal Communications Commission's ("Commission") jurisdiction over the pricing and costing issues the ICAM addresses.

In fact, as U S WEST's experience with the ICAM has demonstrated, the issue of interconnection cost recovery is extremely complex and could not be addressed meaningfully by way of a declaratory ruling. Certainly any cost methodology which identifies interconnection costs must necessarily walk a delicate path. An incumbent local exchange carrier ("LEC") could not reasonably consign all of its network improvement programs to the category of interconnection costs. By the same token, it would be unreasonable and illegal to call network upgrades made at the specific demand of an interconnector part of a general network program (even though the incumbent LEC would never have made the particular reconfiguration on its own). Exempting the demanding interconnector from making full and proper payment would be contrary to law. Making specific decisions on interconnection costs and their recovery must necessarily entail recognition of these extremes. However, a declaratory ruling cannot possibly take into account all of the particular

factual permutations which will arise as interconnectors and incumbent LECs negotiate the proper terms of interconnection agreements and state regulators seek to resolve disputes which negotiations could not resolve.

AT&T Corp.'s ("AT&T") comments demonstrate in several particulars why the declaratory ruling vehicle would be inappropriate for resolving fact-specific interconnection pricing rules, decisions, and disputes.<sup>3</sup> Picking and choosing from among several U S WEST ICAM filings in several states, AT&T suggests that the Commission embark on what would be tantamount to a full-blown ICAM proceeding of its own. The recovery of start-up interconnection costs is indeed an important issue, and failure to permit such recovery of these costs would be a serious regulatory mistake (in addition to being illegal).<sup>4</sup> If the Commission really wants to start a proceeding to determine detailed rules for such recovery, U S WEST will participate. But criticisms of the U S WEST ICAM at this point are simply meaningless, because what ICAM is now is a recommended approach and a series of arguments based on this approach. For the sake of completeness, we attach hereto as Exhibit 1 a copy of U S WEST's Reply Comments in the Minnesota ICAM docket. U S WEST will, of course, be happy to meet with the Commission to describe its ICAM filings in detail.

AT&T's (and others') arguments do point out several dangers of attempting to

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<sup>3</sup> AT&T's Comments filed Apr. 3, 1997.

<sup>4</sup> In this regard, the Opposition of GTE Service Corporation ("GTE") to the Petition is especially salient in pointing out legal pitfalls inherent in any regulatory regime which did not permit full recovery of these costs. GTE Opposition filed Apr. 3, 1997 at 13-15.

deal with the issues raised by the ICAM on the basis of generalizations rather than individual decisions based on factual analysis. AT&T, contending (with characteristic overstatement) that “[t]hese non-recurring charge proposals are among the greatest threats to local competition,”<sup>5</sup> requests that the Commission issue several definitive pronouncements.

First, AT&T requests that the Commission declare that the 1996 Telecommunications Act would be traduced unless recovery of network reconfiguration costs incurred because of demand by AT&T were spread “proportionately across all carriers (including the incumbent). . .”<sup>6</sup> AT&T’s theory is that interconnection costs are really “one-time competition-enhancing investments that benefit all consumers.”<sup>7</sup> AT&T proposes that this proportion be set on the “basis of relative number of retail customers served . . .”<sup>8</sup> The problem with AT&T’s argument is that it is so broad that its scope encompasses the entire spectrum from the reasonable to the preposterous. Certainly the 1996 Act would not contemplate incumbent LECs charging interconnectors for the entire cost of making network upgrades which the LEC would have made in the normal course of business to serve its own retail and wholesale customers. U S WEST has never contended to the contrary in proceedings involving its ICAM or in state arbitration proceedings. On the other hand, AT&T has proclaimed the right to demand that U S WEST’s

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<sup>5</sup> AT&T at 3.

<sup>6</sup> Id. at 4-5.

<sup>7</sup> Id. at 4.

<sup>8</sup> Id. at 5.

network be configured entirely to the special benefit of AT&T — in a manner quite different than U S WEST would even consider designing its network.<sup>9</sup> Should AT&T procure such a right, or obtain U S WEST's acquiescence in such a demand, AT&T clearly would have no grounds on which to claim that U S WEST or others pay for AT&T's custom-design demands.

U S WEST is of the opinion that it is entitled to recover from interconnectors all costs of interconnection and unbundling which U S WEST would not have incurred absent the demand of an interconnector. Moreover, U S WEST has never taken the position that it is entitled to double recovery of these costs. To the extent that costs identified by the ICAM are recovered in charges for interconnection, they would not be recovered elsewhere. In addition, U S WEST's advocacy in various ICAM proceedings has not insisted that all interconnection costs be recovered only from interconnectors — U S WEST's ICAM advocacy presents decision-makers with various options for recovery of these costs. Assessment of interconnection costs solely against interconnectors which cause those costs to be incurred is presented as one of several options presented in U S WEST's ICAM advocacy.

Unless the Commission wants to become involved in the issue of just how far AT&T can go in demanding that U S WEST customize its network for AT&T and how those demands must be compensated for if met, it seems that the prudent course of action is to permit this particular issue to work itself out via existing state commission proceedings. AT&T would then have the opportunity to pursue its

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<sup>9</sup> Arguments by AT&T that these coerced-LEC investments would be made for the benefit of the public, rather than for the benefit of AT&T, are spurious.

concerns through the appellate process.<sup>10</sup>

Second, AT&T proclaims that the Commission should “establish a framework for states to employ in identifying and quantifying the relevant one-time costs.”<sup>11</sup> From AT&T’s perspective, an incumbent LEC would be prohibited from recovering costs incurred in upgrading its existing network to a theoretically perfect network (as envisioned by AT&T). If an incumbent LEC is required by the government (or by AT&T) to upgrade its existing network, the incumbent LEC must be compensated for such upgrades. A decision that incumbent LECs were entitled to recover upgrades only from what AT&T claims should have been an already-perfect network would be clearly confiscatory and arbitrary. But, in the context of AT&T’s constant complaint in other dockets that U S WEST and other incumbent LECs have already spent too much in upgrading their networks, AT&T’s position becomes downright disingenuous.

Third, AT&T contends that the existence of any “barrier to entry” in a local exchange telecommunications market gives rise to sufficient anti-competitive impetus to warrant preempting state regulatory jurisdiction under Section 253 of the 1996 Act.<sup>12</sup> The word “barrier” conjures up visions of barricades and walls precluding entry, and AT&T’s position would require that a competitive service offering be essentially “prohibited” in order to justify preemption. However, AT&T then correctly notes that a barrier to entry is generally viewed by economists as “a

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<sup>10</sup> 47 U.S.C. § 252(e)(6).

<sup>11</sup> AT&T at 5.

<sup>12</sup> Id. at 6.

cost that must be incurred by a new entrant that incumbents do not (or have not had to) bear.”<sup>13</sup> The idea that the 1996 Act authorizes the Commission to upend the entire jurisdictional structure which the 1996 Act sets up in Sections 251 and 252 whenever a cost exists for a new entrant which did not exist for an incumbent finds no support in the 1996 Act itself. Rather, the 1996 Act provides only that state or local action may not “prohibit, or have the effect of prohibiting, the ability of any entity to provide any interstate or intrastate telecommunications service.”<sup>14</sup>

U S WEST does not suggest that this Section of the statute is meaningless — there may indeed come times when Commission action is necessary to protect the pro-competitive goals of the 1996 Act. But, should the Commission establish its preemptive authority based on as slender a reed as is suggested by AT&T, the likelihood of losing its legitimate preemptive jurisdiction at the hands of an annoyed judiciary would be dramatically increased.

These and other issues of cost recovery associated with providing interconnection are clearly complex and important. If the Commission were the proper jurisdiction to determine the optimal cost recovery vehicles for state specific network reconfigurations made to accommodate the unique needs or demands of interconnectors, U S WEST would suggest that a detailed proceeding be commenced at once to address the above issues and the myriad of other matters which would need to be considered in the establishment of rules dealing with such a complex subject. However, the Commission’s jurisdiction over this type of pricing matter is

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<sup>13</sup> Id.

currently questionable at best, and, even if the Commission had the full authority to decree that U S WEST's approaches to state authorities in its ICAM filings were somehow suspect, given the unresolved status of those state proceedings, intervention of the Commission at this time would still seem ill advised.

Accordingly, we request that the Commission simply dismiss the Petition.

Respectfully submitted,

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April 28, 1997

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<sup>14</sup> 47 U.S.C. § 253(a).



**EXHIBIT 1**

**STATE OF MINNESOTA  
BEFORE THE PUBLIC UTILITIES COMMISSION**

**Edward A. Garvey  
Joel Jacobs  
Marshall Johnson  
Mac McCollar  
Don Storm**

**Chair  
Commissioner  
Commissioner  
Commissioner  
Commissioner**

**In re: Petition of U S WEST  
Communications, Inc., for the  
Interconnection Cost Adjustment Mechanism**

**Docket No. P421/EM-97-15**

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**REPLY COMMENTS OF  
U S WEST COMMUNICATIONS, INC.**

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U S WEST Communications, Inc. (U S WEST) has received initial comments filed by the Department of Public Service (DPS), Office of the Attorney General (OAG), AT&T Communications of the Midwest, Inc. (AT&T), MCImetro Transmission Services, Inc. (MCI), Frontier Telemanagement, Inc., et al., (Frontier), MFS Communications Company (MFS), and Minnesota Independent Coalition (MIC). These reply comments are structured in two parts. First, these comments will describe the Interconnection Cost Adjustment Mechanism (ICAM) filing and respond to the common issues and address some general misperceptions of the commenters about the filing. The second part of these reply comments will address the remaining issues raised by the various commenters.

**A. U S WEST'S ICAM PROPOSAL.****1. Introduction.**

In the ICAM filing, U S WEST proposes a mechanism for the complete and timely recovery of the extraordinary expenses and capital investment costs that U S WEST must incur in order to satisfy the requirements of the Telecommunications Act of 1996 and the FCC's First and Second Interconnection Orders. U S WEST must incur these "start-up" costs, based on governmental mandate, to enable competition in the Minnesota local exchange market. U S WEST proposes that these "start-up" costs be recovered over the next three years either through a monthly charge to CLECs that interconnect with the U S WEST network, purchase unbundled network elements, and resell U S WEST services, or through a monthly surcharge on all U S WEST and CLEC customer access lines. U S WEST is establishing a tracking mechanism that will identify and measure the actual extraordinary costs that will be incurred to implement interconnection, unbundled network elements and resale. The ICAM cost recovery mechanism is designed to recover these *actual* expenditures over three years. The ICAM filing is limited to costs that are not recovered elsewhere.

**2. The Need for ICAM.**

The Telecommunications Act of 1996 and FCC's First Interconnection Order have established the blueprint for how local competition will occur, and have imposed a significant set of requirements on U S WEST and other incumbent local exchange carriers. For example, Sections 251(b) and (c) of the Act require U S WEST to, among other things, provide CLECs with interconnection to its Minnesota network, provide

access to unbundled network elements, provide number portability, and allow CLECs to purchase retail telecommunications services for resale at a discount. In order to meet these governmental mandates, U S WEST must spend millions of dollars to:

- rearrange and reconfigure its network;
- add capacity to its network; and
- modify and develop new systems, databases and processes.

Quite simply, the U S WEST network, and related systems, must be fundamentally reshaped to accommodate local competition, and to satisfy governmental mandates. The most efficient network and systems architecture that serves the needs of multiple local providers is significantly different than the most efficient network and systems architecture given one local service provider operating in a monopoly environment.

The government has mandated that U S WEST must spend millions of dollars during a transitional period in order to implement the provisions of the Telecommunications Act and the FCC's First and Second Interconnection Orders. U S WEST understands its obligations under the Act, and plans to make the necessary investments in its network and systems, so that the competitive goals of Congress, the FCC and this Commission can be met. However, U S WEST has a legal and constitutional right to recover these costs, and the Commission, CLECs and U S WEST must work together to establish a means for funding the investments that U S WEST must make to enable competition.

In addition, it is not fair or reasonable to expect U S WEST to "foot the bill" for the implementation of local competition. First—as a fairness issue—U S WEST should

not be required to fund network and system changes that are being implemented for the benefit of its competitors. Second--as an economic issue--U S WEST simply cannot afford to implement the requirements of the Act out of its own pocket. U S WEST does not have unlimited access to capital and, like any other business, must operate within cash flow constraints. U S WEST cannot focus all of its limited resources towards meeting the needs of CLECs at the expense of its retail customers. The ICAM would provide a funding mechanism that would allow U S WEST to make the extraordinary investments that are needed to serve the needs of CLECs without causing unreasonable and undue financial pressure on U S WEST, or unfairly harming U S WEST's customers.

The Act allows this Commission to provide a recovery mechanism for U S WEST's accounting costs related to the provision of interconnection services outside of a rate case rate-of-return proceeding. Since the costs proposed for recovery by U S WEST are those costs for interconnection that are incurred for all carriers collectively rather than specific individual carriers, construction charge recovery, assessed to specific carriers, is not appropriate. Therefore, since no other recovery mechanism provides for this recovery that is allowed by the Act, the ICAM proposal is a reasonable approach. The Act did not specify what type of costs be considered by this Commission for recovery. The type of costs U S WEST is proposing for consideration are the actual costs incurred on a current basis, solely to provide competition and interconnection in compliance with federal and state requirements.

### **3. ICAM is Designed to Recover Extraordinary "Start-Up" Costs.**

As noted above, U S WEST seeks to recover, via ICAM, only the extraordinary costs that it will incur to enable competition. These are "start-up" costs associated with making changes to the network, systems and processes that will be incurred over a transition period so that CLEC needs can be met *now*. These are *not* the ongoing recurring and nonrecurring costs that U S WEST would incur to provide terminating interconnection, unbundled network elements and other services over time.

These costs are *extraordinary* because they would not have been incurred absent a change in federal and state law. These costs are not included in the "business as usual" scenario underlying U S WEST's current rates in Minnesota. U S WEST must make these investments in order to comply with the Telecommunications Act and the FCC's rules and to meet the needs of CLECs. These costs are far over and above the costs that U S WEST could be expected to reasonably incur to serve its own customers.

The Commission has previously recognized that significant costs associated with a mandate should be recovered in a special way. On November 2, 1987, the Commission issued its FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER AND ORDER INITIATING SUMMARY INVESTIGATIONS in Docket No. P-999/CI-85-582 in which it found that intraLATA equal access presubscription was necessary for effective competition. The Commission found further that a method must be established to pay for the development and installation of intraLATA presubscription. This issue and others related to equal access and presubscription were addressed in IN THE

MATTER OF AN INVESTIGATION INTO INTRALATA EQUAL ACCESS AND PRESUBSCRIPTION, Docket No. P-999/CI-87-697 (Docket 697). The Commission's July 21, 1994, Order in Docket 697 proposed a recovery mechanism for intraLATA equal access conversion or implementation costs (Id. at 5-6). The Commission adopted a per minute of use model as the appropriate method of cost recovery and required that the LEC's must amortize the charges over five years. In addition, the Commission provided for a true-up to occur in the final year of the amortization period based on the actual implementation costs. Like the EANR costs, the ICAM costs are required to transition to the competitive environment and a special mechanism for cost recovery is appropriate.

The major extraordinary costs that will be incurred are network and systems costs.

**a. Network Costs.**

U S WEST will incur certain "start-up" costs to set up the network so that CLECs can interconnect with U S WEST, purchase unbundled network elements and obtain number portability. These network costs include both expense and capital items. U S WEST must invest heavily in its network for the sole purpose of serving the needs of interconnectors--investments it would not need to make to serve its own customers. These expenditures will include expansion of facilities for tandem switching, indirect and direct transport trunks, local switching, and equipment upgrades. Because of interconnection, U S WEST must *reconfigure* its network, since the most efficient facility configuration given multiple interconnecting carriers is significantly different--

and more expensive--than the most efficient configuration given one carrier in a monopoly environment. In addition, U S WEST must incur significant extraordinary capital expenditures to *add capacity* to the network--investment that would not have been needed to meet growth needs given the previous "business as usual" environment. Quite simply, the implementation of local competition requires a significant level of extraordinary "start-up" investment in the U S WEST network.

As an example of the extraordinary costs to "set up" the network, consider the following. Prior to the advent of local competition, a high percentage of local calls were intraoffice--that is, these calls originated and terminated in the same central office. For example, assume Customers A and B are U S WEST customers served out of the same local central office. When Customer A places a local call to Customer B, the call traverses the Customer A loop to the central office, utilizes switching in the office, and is sent back out over Customer B's loop. To complete this call, only one switch is used, and no interoffice transport is utilized. This "one carrier" scenario is delineated in Exhibit 1.

Now assume that local competition enters the market and that Customer B decides to select a CLEC such as MFS as her local service provider. Since Customer B will now be served out of the MFS central office, a call between Customer A and Customer B will now follow a more complicated (and more expensive) route. In this scenario, when Customer A places a local call to Customer B, the call still traverses the Customer A loop to the central office, as before, and utilizes switching in the U S WEST central office. However, now the call must be switched to the MFS central



office. The call may be directly routed to the MFS switch, or it may utilize the U S WEST local tandem. In any case, a call between the same two customers, that previously used only one switch, is now a call that uses at least two local switches, transport, and perhaps a tandem switch before terminating at Customer B.

It is readily apparent, as depicted in Exhibit 1, that the existence of more than one carrier significantly increases the cost of transmitting a simple local call--both the total cost and the cost incurred by U S WEST. In the first scenario, U S WEST only incurs local switching costs at one office. In the second scenario, U S WEST incurs local switching costs and potentially transport and tandem switching costs as well before the call is terminated to the CLEC, and must reinforce the public switched network to handle the increased call handling required to accommodate competitors.

The implementation of interconnection requires U S WEST to spend millions of dollars to reconfigure and add capacity to its network. These are costs that are incurred by U S WEST--not its competitors--for the express benefit of these competitors. While Minnesota consumers will realize significant benefits from local competition, the Commission cannot ignore the fact that implementing competition has very real costs--the bulk of which will be incurred by U S WEST. In addition, the Commission must understand that interconnection actually increases the aggregate cost of many calls because the efficiencies of a one-carrier network are lost, as demonstrated above.

The ICAM mechanism proposed by U S WEST represents a way to recover these extraordinary costs, which must be incurred by U S WEST now, in order to enable local competition.

*These extraordinary investments will not be recovered over time in Minnesota's mutual compensation prices.* In theory, if prices were established for the tandem switching, transport and local switching used to terminate calls from CLECs, then some of these extraordinary costs would be recovered over time via these prices, assuming they were set at a level that would recover cost. While this would recover some of the terminating costs, the extraordinary costs associated with originating calls would not be recovered. However, in its Order in Docket No. P-442, 421/M-96-855, et al., the Commission approved "symmetrical" reciprocal compensation rates between local carriers. That is, the prices charged by U S WEST and CLECs for the termination of traffic are the same--regardless of the costs incurred to terminate the call. This does not allow U S WEST to recover any of the extraordinary costs that it will incur to accommodate interconnection--even over time.

This is true because, in most cases, CLECs will incur significantly less costs to terminate a call than U S WEST will incur to terminate a call. As shown in Exhibit 2, when U S WEST terminates a call to a CLEC, the CLEC will incur only local switching costs. When a CLEC terminates a call to U S WEST, the call will in many cases be routed through the U S WEST tandem switch, and then be transported to the U S WEST end office. Thus, U S WEST will incur tandem switching, transport and local switching costs. While U S WEST incurs significantly more costs to terminate a

call, the rate for termination is the same. Therefore, U S WEST is not compensated for its investment even though, in this scenario, U S WEST will have incurred a significant amount of extraordinary costs. U S WEST would have to essentially reconfigure its network (as described above), adding significant tandem switching and transport capacity to serve CLECs. Yet the reciprocal compensation price would not cover any of this cost—even over time. ICAM is needed so that U S WEST can recover these costs.

Even if the Commission had not established "symmetrical" reciprocal compensation rates, there would still be a problem. First, establishing cost-based reciprocal compensation rates would allow U S WEST to recover some of the cost of extraordinary investments added to complete *terminating* calls, but it would not account for the cost of investment added for *originating* calls. Thus, there would only be a partial recovery of these extraordinary costs. Second, any reciprocal compensation rates would allow for the recovery of these costs *over time* as the additional investments are depreciated. As discussed above, U S WEST must incur these extraordinary capital expenditures *now* to enable interconnection and to assure that customers can complete calls between carriers with the level of service they expect and deserve. For example, investments must be added *now* so that customers will not experience a greater probability of call blocking than they are accustomed to with only one carrier. The burden is on U S WEST to add this capacity—and to do it *now*.

The requirement for U S WEST to add significant capacity now puts extreme pressure on U S WEST's capital budget. U S WEST simply does not have unlimited

capital or the discretionary cash flow to meet *all* needs for capital additions--especially the extraordinary ones needed to accommodate interconnection. While U S WEST is required to reconfigure and add capacity to its network to serve CLECs, U S WEST also has carrier of last resort obligations to expend capital to grow and expand its own network to provide high quality services to its customers. U S WEST has been spending heavily to provide high quality service in Minnesota and intends to continue to do so. However, if U S WEST is forced to divert its limited capital resources to meeting the needs of interconnectors, it will not have the resources to continue the investments to meet the growing needs of Minnesota customers.

Therefore, even if the Commission set prices that would allow U S WEST to recover the costs of extraordinary investments over time, U S WEST would experience a cash flow squeeze. If the Commission were to establish cost-based reciprocal compensation rates, it would still be appropriate for the Commission to allow for the accelerated recovery of the extraordinary investments that must be placed to serve the needs of interconnectors. This would provide U S WEST with the cash flow necessary to make these extraordinary investments, and to continue to invest to meet the needs of its own customers.

**b. Systems Costs.**

To accommodate interconnection, unbundling, resale and number portability, U S WEST will need to update existing systems and databases, and develop new systems and databases. Both expense-related and capital-related costs will be incurred to modify and develop systems related to billing, service delivery, service

provisioning, service assurance and capacity provisioning. U S WEST must also set up the electronic interfaces necessary so that CLECs can have mediated access to U S WEST systems and databases, allowing CLECs to order network elements and services for resale on an electronic basis.

To illustrate, in order to make services available for resale, U S WEST must update and modify numerous systems and databases. For example, modifications of existing systems and new systems are required to: modify service order processes to include codes to identify accounts as "resale" by reseller IDs; modify service order processes to provide ability to validate for completeness and correctness; modify systems to assure Customer Provided Network Information (CPNI) is protected in a resale environment; modify systems to add new Universal Service Order Codes for number portability; establish new systems to allow new entrants electronic entry of service requests; establish new systems to provide trunk testing reports to the new entrants; develop systems for notifying CLECs of network trouble; and so forth. In addition to modification and development, there are requirements for expenditures for design, testing, coding of systems, and the purchase of equipment to process and store data.

These costs will be incurred by U S WEST regardless of whether resale transactions are handled through electronic or manual interfaces, although U S WEST must also establish electronic interfaces that will provide resellers with mediated access to systems and databases.<sup>1</sup>

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<sup>1</sup> To implement interconnection, there are also requirements to establish service centers to

Through ICAM, U S WEST seeks to recover systems-related and electronic interface *start-up* costs that are not recovered through other mechanisms. U S WEST proposes that the *ongoing* recurring costs associated with systems usage and maintenance be recovered via a transaction fee, as will be proposed in the generic cost proceeding. The transaction fee will not recover the start-up costs of modifying U S WEST systems or establishing electronic interfaces. In addition, the discounted prices for services available for resale do not include any allocation of these start-up costs.

Therefore, since the extraordinary systems "start-up" costs will not be recovered through any other recovery mechanism, the Commission should allow the recovery of these start-up costs via the ICAM.

#### **4. ICAM Accounting Treatment.**

U S WEST proposes that all extraordinary expense items will be recovered via ICAM as they are incurred over the next three years. All capital expenditures in year 1 will be amortized over three years, to be fully recovered by the end of year three. All capital expenditures made in year 2 will be amortized over years 2 and 3, to be fully recovered by the end of year 3. All capital expenditures made in year 3 will be treated as expenses—or amortized in year 3.

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accommodate taking of non-electronic orders, billing and collection, provisioning and other processes associated with providing service. The start-up costs are primarily required for the expansion of existing service centers to provide additional building facilities, workstations, furniture, office equipment, and initial training.

All the extraordinary capital investments incurred to accommodate interconnection, unbundling and resale will be amortized by the end of year three. Thus, these investments will be "off the books" by the end of year three. This means that these investments will not be part of the U S WEST "rate base" after three years, and would not be included in any future U S WEST "revenue requirement." U S WEST will recover the investment over three years--it will not re-recover these investments again over the "economic" or "prescribed" lives normally associated with the equipment.

U S WEST will incur significant extraordinary costs to change/reconfigure its network, systems, databases and processes to enable competition over the next three years, as we transition to competition. After three years, the bulk of the necessary changes will be made, and the new competitive environment will become "business as usual." Via ICAM, U S WEST is seeking to recover only the extraordinary costs that it will incur during the transition period, i.e., the "start-up" costs of implementing competition.

U S WEST complies with long-standing state and federal requirements to record its financial transactions in accordance with the Code of Federal Regulations, Title 47, Part 32 (the Uniform System of Accounts). These accounting costs have been accepted for decades by this Commission and others as forming the basis for identification of the costs of providing telephony services. Rates for retail services, and wholesale federal access services, have been developed to recover these costs in the past. In fact, to the extent forward-looking cost models use any historical financial data

from ARMIS or other sources, this same data is relied upon for those cost of service studies also.

U S WEST proposes to use its accounting system to identify costs related to the introduction of competition and interconnection. Beginning with the first quarter of 1997, U S WEST proposes to track all expenses and capital expenditures that are incurred to meet CLEC needs for interconnection, unbundling, number portability, resale and other competitive mandates. U S WEST has developed a mechanism for identifying, tracking, and auditing these extraordinary "start-up" costs.

U S WEST will report actual incurred costs on a quarterly basis, beginning with the first quarter of 1997. The ICAM charge will be adjusted to reflect the level of expenditures for these costs, with a delay of approximately three months. At the end of the three-year period, a final "true up" would occur. These expenses will be available for audit by an outside accounting firm.

#### **5. Cost Estimates.**

U S WEST's filing did not include any estimates of the ICAM-related start-up costs in Minnesota. Frontier,<sup>2</sup> in its comments, referred to cost estimates that were provided by U S WEST in the State of Washington. The Commission must understand that despite the inflammatory claims of some parties, U S WEST is not requesting the recovery of costs based on these estimates via the ICAM mechanism. U S WEST will assess ICAM charges based on the actual costs incurred for interconnection, unbundling and resale as measured in the ICAM tracking mechanism. In Minnesota,

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<sup>2</sup> Frontier Comments, page 2.



U S WEST does not propose to assess any ICAM charges, even on an interim basis, based on estimates.

U S WEST is asking for the recovery of actually incurred costs. U S WEST has filed this proceeding to establish a mechanism so that these extraordinary costs can be recovered. U S WEST is asking the Commission to consider the proposed ICAM mechanism which will allow U S WEST to recover over three years the actual extraordinary costs that it will incur so that it will be able to offer interconnection, unbundled network elements, and resold services per governmental mandate. As described above, U S WEST will implement a tracking mechanism to identify these actual costs.

There are five key initiatives that U S WEST will develop under the competition mandates. They are activities related to: (1) resale; (2) unbundling; (3) local interconnection; (4) number portability (both interim and permanent); and (5) private line transport services. These initiatives will require resources in the categories of systems, business office processes, and network.

In each of these five initiatives, U S WEST will separately track and report its incurred start-up costs of these activities. For example, systems costs will include direct charges to uniquely identified interconnection project codes. These charges will include standard labor rates for the hours charged to each project, actual non-labor expenses and capital needed for each project, and vendor charges for each project.

Business office processes for wholesale activities such as Public Access Line services, Centrex Resale services, and Shared Tenant services are conducted in the